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General Business Conditions

THE softening in prices of basic commodities, together with the persistent slackness in the consumers' goods industries, has kept business sentiment conservative during February. The tendency of buyers to shorten commitments, which appeared first in soft goods last spring and gradually spread, has become more pronounced as fears of shortages have moderated. Lately even the prospect for metal supplies, as the year goes on, has looked better. The second-quarter pinch on non-defense producers will be severe, largely because of the low allotments of copper and aluminum, but the general feeling now is that more metals will be available in each succeeding quarter even after supplying military needs. Meanwhile distributors of consumers' durable goods, with some exceptions, have ample stocks to meet present demand, and expect to get through the tight period without many shortages.

The decline in industrial raw material prices has been most marked in the textile fibers and in hides, and the weakness has been mostly on the demand side. Although retail and wholesale inventories of textiles and apparel are no longer much of a problem, business at the mill level shows little improvement. Buyers all along the line limit their purchases to immediate needs and to bargains that they can turn over quickly. How long this will persist is of course impossible to say. The fundamental reason for the policy is that consumers also are "shopping", and profit margins are thin.

The favorable side of the consumers' goods markets is that price and inventory adjustments have been under way for a good many months. Distributors have been living partly off stocks, and probably consumers also. Prices of wool, hides, and cotton print cloths are all lower than before Korea; in view of the general inflation and high level of purchasing power, this is entitled to be called a drastic correction. The extremes to which market miscalculations and swings of sentiment may go are illustrated by the fact that the same wool which sold at $3.50 a pound or higher a year ago is today bringing about $1.60 — without any significant change in the supplies available.

Inventory Buying Subsides

In broad terms—with exceptions chiefly among companies receiving defense orders — it seems that the period of anticipatory buying and resulting inventory accumulation, which in most consumers' goods ended some time ago, has now passed its peak generally. As manufacturers become more confident that an easier metals situation is in sight they react as consumers and distributors did earlier. They cut their purchases back to current consumption levels, or lower. They switch emphasis from protection of requirements to higher turnover. The influence of their financial officers, concerned with the decline in cash ratios and the heavy tax payments due March 15 and June 15, is exerted on the

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side of inventory reduction. All this adds up to a drop in demand which in turn makes supplies look more abundant.

To some extent developments in the general situation have helped ease the pressures on the markets. The "stretch out" of the defense program — cutting down the peak and spreading the expenditures farther into the future — has resulted in modification or deferment of projects, notably in aviation, that were expected to be getting under way around this time. Sentiment is additionally influenced in some degree by foreign developments. With their currencies under pressure again and the need to reduce imports and increase exports, the sterling area countries and France especially will try to improve their situation by buying less abroad. This may reduce demand for some American civilian goods, and for the products of some of our good customers. World prices for metals, which have been far above American ceilings, have eased considerably.

Production Trend Sideways

While the markets are slack, little effect is seen in overall production or employment. Output of consumers' goods is curtailed and plainly will continue so, but the machinery and equipment industries, metals, petroleum, chemicals, and everything having to do with defense are keeping the country busy. Detroit has a severe unemployment problem, which is duplicated in lesser degree in some other consumers' goods centers, but defense plants are looking for workers and total unemployment is subnormal by any reasonable standard. In the aggregate of industrial production the ups and downs of the various industries have about cancelled out through the last six months, and the Federal Reserve Board's index has held almost unchanged around 218 (1935-39 = 100) during that period.

Easing in metal supplies will permit increases in production. The automobile manufacturers are eager to get more copper and aluminum. They have been selling about as many cars as they could make this winter, and it is their opinion that if second quarter output should be limited to the 930,000 passenger cars for which steel is allowed — to say nothing of the 800,000 for which they have been allotted copper — the demand for popular makes in the spring will not be satisfied without delays. By reason of larger lead supplies, battery production will now be greater than forecast. Somewhat larger metal allotments have been given to manufacturers of minor civilian items, many of whom were almost out of business. On the other hand, makers of heavy household equipment, who are under no extraordinary pressure of demand, have been cut down.

Since most people concede that more metals would be consumed if they were available, fear that an easing in the metals situation is somehow a sign of imminent depression is paradoxical. The fact is that the subsidence of inventory demand on the part of business, like the reduction in consumer spending and increase in saving which began many months ago, contributes to order and stability. An economy which has experienced as much inflation as this country's, and which faces continued inflationary dangers through increased government spending, deficits and wage demands, needs the kind of sober behavior which buyers are now showing.

Corporate Earnings in 1951

Annual reports for 1951 show in the aggregate a substantial expansion in the dollar volume of sales and revenue receipts to new high levels. Operating earnings also were higher, but a sharp jump in federal taxes caused a moderate decline in the net income after such taxes. Trends were less favorable in many of the consumer goods industries, however, some of which were hard hit by material shortages and others by overproduction and inventory losses. In those cases where the expansion in sales lagged, the impact of higher taxes and other costs upon net profit margins was particularly severe.

A continued heavy absorption by business of capital funds, particularly in inventories and in plant expansion, resulted in a sharp rise of both current and long-term debt and lowered somewhat the balance sheet liquidity.

Our tabulation of the reports for 1951 now issued by 2,195 corporations shows combined net income of approximately $8.1 billion after taxes, compared with $8.5 billion in 1950, a decrease of 5 per cent. Net assets or net worth of the group totaled $78 billion at the beginning of 1951, upon which the year's net income represented an average return of 10.3 per cent, compared with net assets of $72 billion in 1950 and a return of 11.9 per cent.

A preliminary summary of the comparative net income for the two years is given below. Our more detailed summary, including a great many additional companies whose statements have not yet been released, will be given in the April issue of this Letter and will show, by major industry groups, the average rates of return on net assets and the profit margins on sales.

Preliminary Summary of Net Income of Leading Corporations for the Years 1950 and 1951

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1950	Reported Net Income After Taxes 1951	Per Cent Change
17	Baking	$ 54,854	$ 44,311	—19
18	Meat packing	52,177	46,261	—11
17	Sugar	38,136	49,459	+30
62	Other food products	189,260	159,515	—16
37	Beverages	163,474	136,162	—17
16	Tobacco products	135,873	107,713	—21
30	Cotton goods	68,951	63,850	— 8
52	Other textile products	162,822	124,475	—24
22	Clothing and apparel	18,019	12,832	—29
23	Shoes, leather products	30,688	25,388	—17
19	Tires, rubber products	157,164	177,848	+13
23	Lumber and wood prod.	42,522	39,986	— 6
46	Paper and allied prod.	176,486	201,905	+14
43	Chemical products	690,797	581,246	—16
24	Drugs, soaps, cosmetics	146,847	139,707	— 5
12	Paint and varnish	32,246	28,754	—11
44	Petroleum prod. & ref.	608,884	717,454	+18
14	Cement	33,175	28,559	—14
7	Glass products	103,918	74,461	—28
22	Other stone, clay prod.	99,103	86,730	—12
35	Iron and steel	741,128	647,094	—13
9	Agricultural implements	170,356	138,605	—19
41	Bldg., heat., plumb. eq.	72,413	61,882	—15
35	Elec. equip., radio & tv.	208,855	178,153	—15
27	Hardware and tools	27,664	33,108	+20
18	Household appliances	40,417	28,760	—41
92	Machinery	94,434	114,716	+21
15	Office equipment	71,997	68,612	— 5
75	Other metal products	421,022	426,779	+ 1
11	Autos and trucks	163,876	100,432	—39
39	Automobile parts	119,473	100,122	—16
19	Aircraft and parts	40,384	41,917	+ 4
56	Misc. manufacturing	53,005	70,828	+34
1,020	Total manufacturing	5,230,420	4,852,124	— 7
15	Coal mining*	33,036	36,935	+12
12	Metal mining*	22,665	38,783	+71
6	Other mining, quarry*	37,839	36,406	— 4
33	Total mining, quarrying	93,540	112,124	+20
15	Chain stores—food	64,057	50,300	—21
32	Chain stores—variety	102,749	91,447	—11
35	Department & specialty	101,129	85,331	—16
36	Wholesale & misc.	54,890	67,999	+24
118	Total trade	322,825	295,077	— 9
129	Class 1 railroads	783,572	693,000	—12
14	Traction and bus	1,649	3,131	+90
13	Air transport	21,845	31,346	+43
28	Misc. transportation	15,267	15,174	— 1
184	Total transportation	822,333	742,651	—10
145	Elec. power, gas, etc.	682,165	687,132	+ 1
30	Telephone & telegraph	381,867	395,285	+ 4
175	Total public utilities	1,064,032	1,082,417	+ 2
13	Amusements	24,417	24,670	+ 1
22	Restaurant and hotel	3,565	2,695	—24
19	Other business services	32,722	32,467	— 1
10	Construction	7,956	7,123	—10
64	Total amus., services, etc.	68,660	66,955	— 2
299	Commercial banks†	499,950	509,286	+ 2
22	Fire & casualty insur.†	56,076	53,294	— 5
160	Investment companies†	232,752	230,719	— 1
50	Sales finance companies	96,553	95,891	— 1
70	Real estate companies	17,633	15,054	—15
601	Total finance	902,964	904,244	+—
2,195	Grand total	$8,504,774	$8,055,592	— 5

* Net income is reported before depletion charges in some cases. † Figures represent in most cases operating earnings only, excluding gains or losses on investments.

In the manufacturing industries, the figures now issued by 1,020 companies show that the numbers with increases and with decreases of net income as compared with 1950 were about evenly divided. The combined net income was down 7 per cent. This decrease turns out to be somewhat less than had been generally expected, due to the fact that a great many companies, notably in the petroleum industry, enjoyed increases in sales sufficient to offset rising taxes and other costs and to increase their net profits substantially. Other lines reporting increases in the group totals, though with wide differences among the individual companies, include sugar, paper and allied products, rubber, and machinery.

Declines in net income, however, were experienced by a majority of the manufacturing groups, despite increases in dollar volume of sales in most cases. In the steel industry, which established a new high production record of 105 million tons of ingots and castings, the 35 reporting companies had an increase in dollar sales of 22 per cent, but a decrease of 13 per cent in net income after taxes.

Declines in net income occurred also in most of the metal-working industries, including agricultural implements, building supplies, electrical equipment, household appliances, automobiles and parts. Earnings in many of the lighter consumer goods industries were cut seriously by rising operating costs and taxes, as well as by falling sales and by inventory losses in some cases. These included most branches of food products, beverages, tobacco, textiles, clothing, and shoes.

In lines other than manufacturing, the summary shows that public utility earnings were well maintained. There was a continued growth in revenues, reflecting the great postwar expansion in plant and equipment. Railroad gross revenues were up by 9 per cent, but estimated net income was down by 12 per cent. Lower earnings are indicated by the preliminary group totals for retail trade, and moderate changes for most of the service and financial groups.

Analysis of the tax details given on the income statements of 117 large manufacturers, each having sales of over $100 million, shows an increase of 16 per cent in earnings before taxes. This was more than wiped out by the jump in federal income taxes from $2.3 billion to $3.5 billion. Such taxes took 61 per cent, or well over half, of the operating income in 1951, compared with 48 per cent in 1950. Last year the federal income tax alone, exclusive of all other federal, state, and local taxes, represented an average of 7.0 cents on every dollar of sales which aggregated $50 billion. This compared with an average of 5.6 cents for taxes in 1950.

The following table shows the enormous increase since 1940 in the tax load, which of

course affects production costs, of some of the larger manufacturing corporations.

Federal Income Taxes of Large Industrial Taxpayers

(In Millions of Dollars)

	1940	1950	1951
Allied Chemical & Dye Corp.	$10	$38	$66
American Cyanamid Co.	8	36	49
American Tobacco Co.	9	32	45
Armco Steel Corp.	12	48	69
Bethlehem Steel Corp.	22	122	162
Chrysler Corp.	23	128	79
Deere & Co.	8	34	60
Firestone Tire & Rubber Co.	2	39	76
B. F. Goodrich Co.	2	45	79
Goodyear Tire & Rubber Co.	2	49	75
Inland Steel Co.	6	41	54
International Business Machines Corp.	3	28	49
International Harvester Co.	5	48	114
Jones & Laughlin Steel Corp.	3	34	54
National Steel Corp.	7	61	95
Pittsburgh Plate Glass Co.	6	44	78
Procter & Gamble Co.	6	33	55
R. J. Reynolds Tobacco Co.	9	37	60
Republic Steel Corp.	8	79	117
Standard Oil Co. (Ind.)	9	54	92
Union Carbide & Carbon Corp.	22	114	164
United States Rubber Co.	4	31	71
United States Steel Corp.	26	234	398
Western Electric Company	16	32	99
Westinghouse Electric Corp.	18	77	104

Effects of Price Inflation

In appraising current earnings of corporations, generous allowance must be made for the effects of the price inflation of the twelve years since 1939 upon several of the widely-used comparisons.

Rising prices have swelled the dollar totals of sales and given an exaggerated impression of the real growth.

Soaring prices have permitted low-cost goods to be sold out at inventory profits. These book profits amount to billions of dollars, despite widespread efforts by accountants to neutralize them in income accounts by the use of the LIFO method of valuation, special reserves, etc.

Depreciation charges on plant and equipment, based upon original costs, have lagged far behind a present-day replacement basis, resulting in a corresponding overstatement of reported earnings.

A number of companies in recent years have stepped up their depreciation rates to make allowance for the rising costs of plant replacement, even where such accelerated depreciation is not an allowable deduction for taxes. Other companies building defense-supporting facilities have qualified for government permission to amortize a specified portion of the costs at a rate of 20 per cent annually. For the majority of industrial companies, however, published financial statements suggest that the prevailing practice is still to base the depreciation charges upon original costs without acceleration of rates.

Both in the case of inventory gains and of profits resulting from the underdepreciation of fixed assets, business concerns are paying taxes on what are in effect fictitious rather than real earnings.

Rising prices not only swell the reported earnings, but also tend to further overstate the rates of return on a corporation's net assets, which in most cases are carried on the books far below present-day values.

Corporate Uses of Funds

The high business volume and rising prices of last year, combined with the heavy expansion of industrial plant for meeting the needs of the national defense program, caused American business to absorb new funds at almost the same record-breaking rate as in 1950. A composite balance sheet is given below of 150 manufacturing companies, each having sales or total assets over $5 million, for which detailed statements are available at this date.

Composite Balance Sheet of 150 Manufacturing Companies with Sales or Total Assets over $5 Million

(In Millions of Dollars)

Assets	1940	1945	1950	1951
Cash	$ 613	$ 886	$1,065	$1,128
Government securities†	38	747	1,424	1,407
Receivables, net	507	918	1,470	1,607
Inventories*	1,358	2,184	3,650	4,589
Total current assets	2,516	4,735	7,609	8,731
Land, plant & equipment	3,433	3,994	6,686	7,573
Less depreciation	1,613	2,440	3,197	3,481
Net property	1,820	1,554	3,489	4,092
Other assets	500	431	452	474
Total assets	4,836	6,720	11,550	13,297
Liabilities and Capital				
Notes payable	97	243	294	536
Accts. pay., accruals, etc.*	349	655	1,145	1,313
Reserve for taxes†	244	768	1,234	1,678
Total current liab.	690	1,666	2,673	3,527
Bonds, notes, etc.	633	663	1,660	1,975
Reserves	74	142	185	198
Capital and surplus	3,439	4,249	7,032	7,597
Total	4,836	6,720	11,550	13,297
Working capital	1,826	3,069	4,936	5,204
Ratios:				
Cur. assets to cur. liab.	3.6	2.8	2.8	2.5
Cash & govts. to cur. liab.	0.9	1.0	0.9	0.7
Equity capital to total liab.	2.6	1.8	1.6	1.4

† Before deducting tax notes offset against taxes payable.
* Includes advances on government contracts.

This group of larger manufacturing companies together had sales and other revenues last year of approximately $19 billion. They showed total assets at the year-end of $13.3 billion – an increase of $1.7 billion during the year.

By far the largest portion of this increase was $939 million, or 26 per cent, in inventories, reflecting both inventory accumulation and higher prices. Second largest increase was $603 million in net property account, after deducting $284 million added to the accrued reserve for depreciation. Expenditures for plant expansion and modernization were particularly heavy in

steel, nonferrous metals, chemicals, and petroleum. Accounts receivable were up moderately, as was cash.

About half of the total funds used last year came from an increase in the current liabilities for notes payable and for tax reserves, plus the accounts payable, accruals, etc. The other half came mostly from the building up of capital and surplus through retained earnings, only 58 per cent of which was paid out in dividends. Over $300 million came from increased borrowing on long-term bonds, notes, etc.

Although the net working capital, or excess of current assets over current liabilities, continued to increase last year, the balance sheet reveals an unmistakable decrease in liquidity. For example, the ratio of total current assets to current liabilities on December 31, 1951 stood at 2.5 times, whereas in 1950 it was 2.8, and in 1940 it was 3.6. Leaving out the swollen inventories, as well as the receivables, the ratio of cash and government securities alone to current debt at the end of 1951 was only 0.7 times, as against 0.9 in 1950 and 1940. Similarly, the ratio of equity capital, represented by the book value of capital and surplus, to total current and long-term debt declined to 1.4 times by the end of 1951, as against 1.6 in 1950 and 2.6 in 1940.

While this composite statement tends to cover up infinitely diverse trends among different industries and individual companies, including many thousands of family-owned manufacturing enterprises which publish no financial details, the overall totals do illustrate the continuing problem of obtaining adequate capital. Although the main source of permanent capital since the war has been, fortunately, retained earnings rather than long-term debt, more than one-half of industry's operating earnings are now being taken by federal taxes. Present rates, which run up to 82 per cent on the income defined as "excess" relative to a base period, make it difficult for most concerns either to build up equity capital or to sell new stock to investors.

During the year 1951, in the face of record demands for additional business capital brought about by inflationary conditions and by the plant expansion program, and despite the fact that the income before taxes of all U.S. corporations is estimated by the Department of Commerce at an all-time high record of $44.5 billion, the retained net income placed at $8.6 billion after dividend payments is the lowest since 1946. Moreover, this retained income is measured in dollars whose real value in term of purchasing power has been progressively shrinking.

Treasury Financing

The Secretary of the Treasury, on February 13, announced plans to anticipate the $10½ billion public debt maturities of March 15 and April 1 by offering the holder opportunity to take other securities in exchange on March 1. Books were opened February 18-21 for exchange subscriptions as follows:

New 2⅜ per cent 5-7 year bonds maturing March 15, 1959 and callable for payment on or after March 15, 1957 were offered in exchange for $1024 million 2½ per cent bonds of 1952-54, called for payment March 15.

New 1⅞ per cent certificates maturing February 15, 1953 were offered in exchange for $9524 million 1⅞ per cent certificates due April 1.

In connection with the announcement of these exchange offers, the Secretary revealed that he would not exercise his option to call three issues of 2 and 2¼ per cent bonds, totalling $7.8 billion, which might have been called for payment on June 15 but do not actually fall due until 1954 or 1955. There was no apparent advantage to the Treasury in issuing a call for payment. On the other hand, deferring the three issues lightens the load of new Treasury issues that will have to find a market later this year. From July through December the Treasury will have five issues of certificates, for a total of $19½ billion, coming due and besides will have to float something like $10 billion new securities to finance the prospective deficit.

The New Issues

The new 5-7 year 2⅜ per cent bond is the first offering since 1945 of a marketable government security with a maturity beyond five years. It seems to represent an experimental departure from the general practice of asking holders of bonds to take short-term paper at low rates. The 2⅜ per cent rate represents an improvement of ⅛ per cent over the best rate previously offered on marketable securities in the postwar period, though it does not attempt to meet the competition of top-grade corporate bonds which are being placed in the interest rate range of 3 to 4 per cent.

The offer of new 1⅞ per cent certificates maturing February 15, 1953 in exchange for the April 1 1⅞s seemed a fair rate in view of prevailing rates for short-term money though a large turnover of the April 1 certificates was precipitated. Many of these certificates have been held as reserves for taxes due March 15 or June 15. Also, in light of the prospective strain on the money market resulting from March tax payments, and the prospective credit demands in the second half of the year, there was some reluctance to tie up money for nearly a year at

the 1⅞ per cent offered on the new certificates. This rate, adopted last June for a nine months' certificate issue, may be wearing a little thin. Sellers of the April 1 certificates generally shifted into Treasury bills or shorter certificates as an interim investment and yields on bills, under the influence of these demands, temporarily dropped to 1½ per cent.

Federal Reserve Open Market Operations

Both the new bonds and certificates were rather closely priced in the market and, to insure a high percentage of exchanges, the Federal Reserve System put in premium bids for the maturing securities or "rights" to subscribe to the new issues. In the two weeks February 13-27, the Federal Reserve bought $950 million of the "rights" but sold certificates maturing July through December on a nearly equal scale and thus avoided any considerable increase in its holdings of government securities. The following table shows these transactions against the background of the purchases to relieve the year-end pinch of funds and the sales since then.

Federal Reserve Open Market Operations

(In Millions of Dollars)

	Dec. 19 to Jan. 2	Jan. 2 to Feb. 13	Week Ended Feb. 20	Week Ended Feb. 27	Holdings Feb. 27
Cert. rights	—	—	+465	+193	$ 3,818
Bond rights	—	—	+127	+165	339
Bills	+371	— 488	—	—	—
Certificates*	+ 38	— 671	—691	—203	8,033
Notes	—	—	—	—	5,068
Bonds*	+ 10	—	—	—	5,297
Total	+419	—1,159	— 99	+155	$22,555

* Excepting issues made exchangeable for new certificates and bonds.

Sales in the first six weeks of the new year absorbed idle funds accumulating in the banks in this period, especially from seasonal reduction in currency circulation. Treasury bills, which traded during December at yields to the buyer above 1.90 per cent, recently have traded to yield 1½ to 1⅝ per cent. Bank loan demands have been moderate since December; expansion of defense loans has been offset by repayments of other loans.

Federal Reserve spokesmen have described their policy in recent months as one of "neutrality". This is descriptive of policy on the discount rate, which indeed has been left unchanged at 1¾ per cent for a year and a half while many market rates of interest have moved up ½ to 1 per cent. While banks have had little occasion for borrowing since December, the present level of the discount rate holds out an abnormal inducement to borrowing by banks from the Federal Reserve.

Federal Reserve transactions in the government security market have been neutral in the sense that sales have been conducted alternately with purchases although the System's total holdings of government securities have increased $674 million since the bond market was "unpegged" in March 1951. Evidently, there will be a very real problem of holding the portfolio down during the second half of this year when large scale deficit financing will coincide with loan demands to finance the crops and the fall and Christmas trade.

Deficit Financing

It is a simple matter to finance deficits by currency inflation, using the Federal Reserve Banks to buy up government securities carrying rates too low to attract a broad investment demand. Financing a deficit without adding to inflationary pressure is infinitely harder. The best way to handle a deficit is to eliminate it by cuts in expenditures. Next best is to design securities with a real sales appeal and fortify the will to save. This requires consideration of what interest return the saver will consider acceptable and attractive.

The saver has been getting the short end of the stick since the policy of driving interest rates down, and keeping them down, was adopted as official government policy fifteen or twenty years ago. But he has been showing some signs of restlessness in the postwar period. The saver has no organized lobby to defend his interest but he is not entirely helpless. He has the option, for example, to buy or not to buy Savings bonds, life insurance or annuities, and to seek a higher rate on his savings. By his choices, exercised in a competitive market, he can bring pressure to bear on credit institutions and borrowers to pay him a better rate.

The continuing large volume of savings in the United States not only has provided a source of funds for home-building and useful capital projects of every sort but also has been a buffer against inflation. The following table shows the supplies of savings made available, principally by individuals, through four important channels: government bonds; time deposits in commercial banks; deposits in saving banks; and share capital of saving and loan associations.

One obvious feature of this table is the steep rise in individuals' holdings of government bonds (mostly Savings bonds) during the war, the slackened rise 1946-49, and the small decrease in such holdings since 1949 despite the further rise in "disposable income" (the aggregate of estimated personal incomes after tax). As the lower section of the table shows, government securities held by individuals were up

Disposable Income and Savings, 1935 to 1951

(In billions of dollars)

	1935	1940	1946	1949	1951
Disposable income (total personal income less taxes)	$58.0	$75.7	$158.9	$186.4	$222.6
Gov't. bonds held by individuals*	8.5	10.1	63.2	66.9	66.4
Time deposits in commercial banks*	12.8	15.5	32.4	36.3	36.8
Total deposits in mut. savings banks*	9.8	10.6	16.3	18.9	20.4
Share capital of sav'gs. & loan assoc.†	4.3	4.3	8.5	12.5	16.1
Total, for four savings items	$35.4	$40.5	$120.4	$134.6	$139.7

Percentages of Disposable Income

	1935	1940	1946	1949	1951
Gov't. bonds held by individuals*	14.7%	13.3%	39.8%	35.9%	29.8%
Time deposits in commercial banks*	22.1	20.5	20.4	19.5	16.5
Total deposits in mut. savings banks*	16.9	14.0	10.3	10.1	9.2
Share capital of sav'gs. & loan assoc.†	7.4	5.7	5.3	6.7	7.2
Total, for four savings items	61.1%	53.5%	75.8%	72.2%	62.7%

* June 30. † December 31.

Source: U. S. Department of Commerce, U. S. Treasury Bulletin, Federal Reserve Bulletin, Savings and Mortgage Division of American Bankers' Association.

to 40 per cent of disposable income in 1946, slipped to 36 per cent in 1949, and in 1951 were down to 30 per cent.

Savings through commercial banks, mutual savings banks, and savings and loan associations had a large rise from 1935 to 1946 but failed to keep full pace with the inflation of disposable income. In the five years 1946-51, savings through these three types of institutions continued to grow but savings and loan associations alone kept ahead of the rise in disposable income.

The sum of all four types of savings, it is interesting to note, has dropped from 72 to 63 per cent of disposable income since 1949. This shows how hard it has been for the saver to keep up with inflation. It also reflects the use of savings in these forms to buy homes, household goods, common stocks or other equities, sometimes with an eye to "hedging" against inflation or getting a better rate of return.

Rate Consciousness

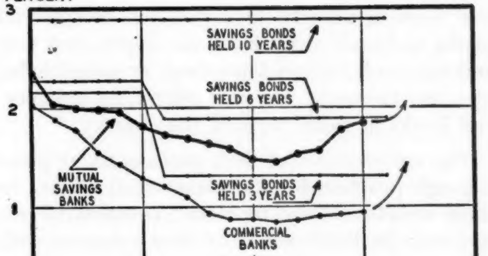
One encouraging thing is that savers are demonstrably responsive to moderate increases in rates offered. The outstanding postwar growth record of many savings and loan associations is a case in point.

Indeed, postwar growth trends set out in the foregoing table are related throughout to rates offered, in an environment where the saver is increasingly rate conscious and inclined to seek a better return consistent with the degree of safety and liquidity he requires. The following chart shows average rates of interest paid on commercial bank time deposits and mutual savings bank deposits since 1935, and also the rates offered on Savings bonds (Series E since 1941) for three, six and ten years' holding.

The rate offered on Savings bonds has been 2.9 per cent for ten years' holding ever since they were first put on the market in 1935. (Up to 1941 Saving bond interest had an added feature of tax exemption.) But Treasury figures show that less than half of Saving bonds sold are retained for the full period and the full return. Redemption prior to maturity has always been penalized. The penalties were increased when the Series E bond was introduced and tax exemption removed in 1941. The rate of return, for example, was reduced from 2.16 per cent to 1.31 per cent for three years' holding and from 2.29 per cent to 1.90 per cent for six years' holding.

Force of Mortgage Demands

The crumbling of the extreme easy money policy since the war, under the weight of the large credit demands which it encouraged, led savings institutions to offer more normal rates of interest as their circumstances permitted or their competition compelled. Mortgage credit demand was a prime moving force and as early as 1947 institutions active in real estate financing began to advance rates offered. Observation of the deposit growth of institutions which raised rates gradually led other institutions to follow suit.



Rates of Interest Offered on U. S. Savings Bonds and Average Rates Paid on Time or Savings Deposits by Insured Commercial Banks and Insured Mutual Savings Banks.

Note: Arrows suggest probable 1951-52 movements of interest paid by commercial and mutual savings banks.

Source: For rate of interest offered on Savings bonds, Treasury Department; for average interest rates paid by insured commercial and mutual savings banks, Annual Reports of the Federal Deposit Insurance Corporation. Average interest rate paid by mutual savings banks as reported by the FDIC for 1935-42 is adjusted for comparability with 1943-50 data.

Comprehensive data are not available on dividend rates paid by savings and loan associations on their share capital. The investment is contractually less liquid than a Savings bond or a savings deposit in a bank and the rates paid cover a rather wide range. But it is clear that many such associations, moved to pay higher rates to attract more funds, had a surprisingly favorable response. In contrast to a typical range of 1½ to 2½ per cent offered by savings and loan associations in 1945 or 1946, at the height of the cheap money policy, the common range today is 2 to 3½ per cent.

Mutual savings banks which were paying 1½ per cent in 1946 tended to move their rates up to 2 per cent in 1948 or 1949. In New York last summer savings banks requested the State Superintendent of Banks for permission to pay higher rates. On February 7 of this year permission was granted to pay up to 2½ per cent and a number of the banks have indicated their intentions to move up to 2¼ or 2½ per cent, rates already being paid by savings banks in some other States.

Commercial Bank Thrift Accounts

Commercial banks, with some few exceptions, have lagged behind in advancing rates. Discriminated against during the war in the rates of interest offered them by the Government, and competitively handicapped by heavy taxation and cash reserve requirements, commercial banks put rates offered on time deposits down to 1 per cent or even less during the war. As a result of the strength of credit demands, the rise in the rate paid by the Treasury on its short-term borrowings, and competitive factors, there has been a definite tendency for commercial banks to break away from the 1 per cent rate and rates of 1½ and 2 per cent, or even higher in a few instances, are now offered by commercial banks in some parts of the country.

The maintenance of their position today poses a tough problem for the commercial banks. In their structure they represent competitive enterprise. In thrift accounts they compete with government bonds or with mutual institutions, taxed much more lightly if at all. Yet thrift deposits are a main reliance of these banks, especially in smaller communities where checking accounts alone do not develop enough deposit volume and income to support a commercial bank.

There is always danger in a situation of this kind that savings institutions may be led to take excessive risks in their loans and investments in order to pay better rates and obtain a competitive advantage. This is something their boards of directors and trustees need to bear in mind. The other side of the argument, as New York Banking Superintendent William A. Lyon has put it, is that "the interest of the depositor is sovereign". By seeking out a higher return, indeed, the saver can put a savings institution under the practical necessity to raise the rate offered in order to hold deposit volume.

Meeting the Savers' Demands

This is the frame of reference in which the Treasury has to design securities for financing the deficit that will be experienced during the second half of this year. Beyond holding down expenditures to minimize the deficit, the need is to avoid borrowing from the Federal Reserve System or — what amounts to the same thing — offering securities which cannot be sold unless the Federal Reserve pumps out more money by buying up already outstanding Treasury obligations.

The two main media for non-inflationary financing are (1) the Saving bond and (2) a marketable bond attractive not only to savings institutions but also to life insurance companies, pension funds, and the individual investor who may prefer a marketable type of security. Savings bond holdings by individuals hit a peak of $50 billion in the summer of 1950. Since then the figure has tended to recede, through an excess of redemptions over sales, and is now below $49 billion. The redemptions have been easy to manage thus far but the need is clear to turn the figures around and realize funds for deficit-financing. Patriotism is one good selling point but it now seems clear that improvement in the terms offered will be required to strengthen the sales appeal.

The offer of a long-term marketable bond would put the Treasury in competition with the mortgage and corporate and municipal bond markets. The scale of mortgage financing, while somewhat reduced, continues at a phenomenal rate by prewar standards, and corporation new-money bond issues have been running at a rate of $4 to $5 billion a year on top of State and municipal new-money borrowing of $3 to $4 billion a year. These flows of savings funds, basically supported by the individual saver, can be tapped by the offer of suitably attractive rates on government bonds, indirectly bolstering the efforts of savings institutions to build up the savings streams in the interest of economic stability and the enduring value of the dollar.

Senator Byrd Shows the Way

When President Truman submitted his $85 billion federal budget for fiscal 1953 to the Congress in January, the almost unanimous reaction even among his own Party leaders was that it was much too big, and should be reduced.

This was true not only of such consistent advocates of economy as Senator Walter F. George, chairman of the tax-raising Senate Finance Committee, who called for a cut of $5 to $7 billion, and Senator Paul H. Douglas, a well-posted and relentless foe of governmental waste and extravagance, who proposed a cut of $7 billion, including $4 billion from the military which he asserted could be made "without reducing our fire-power or effectiveness at all."

It was true also of such Administration stalwarts as Representative Clarence Cannon, chairman of the House Appropriations Committee, who has disparaged previous attempts to trim the budget but who now declares for cuts in all categories, including defense items. Senator Joseph C. O'Mahoney, chairman of the Senate subcommittee in charge of defense appropriations, and not heretofore noted as an economy enthusiast, announced he was asking the Defense Department to "justify in detail" all proposed "traditional" expenditures, stating "I want this information with a view to trimming as much as possible from the waste of preparedness." Similar sentiments were voiced by Representative George H. Mahon, chairman of the House Appropriations subcommittee, Senator Richard B. Russell, chairman of the Senate Armed Services Committee, and others.

It remained, however, for Senator Harry F. Byrd, of Virginia, chairman of the Joint Congressional Committee on Reduction of Nonessential Federal Expenditures, to present the first comprehensive analysis of the President's budget with a view to showing where substantial savings could be made without affecting indispensable items. In his statement released to the press on February 14 which, in the words of Arthur Krock of the New York Times, "as usual has fallen soundlessly into a gulf of general indifference," the Senator gives a searching examination of the President's figures, and offers an alternative "Byrd budget" providing for savings of $8 to $9 billion.

The "Byrd Budget"

The following table compares the President's budget for the coming fiscal year with the Byrd recommendations, by major categories.

Expenditure Budgets for Fiscal 1953

(In Billions of Dollars)

Categories	Truman Budget	Byrd Budget	Difference
Interest, claims, Judicial, Legislative, etc.	$ 7.3	$ 7.3	—
Foreign aid:			
Military	8.0	7.9	—0.1
Economic	2.5	—	—2.5
Foreign relations (including State Department)	0.3	0.2	—0.1
Military Establishment	49.6	47.0	—2.6
Military-related	2.9	2.8	—0.1
Veterans	4.2	4.0	—0.2
Domestic-civilian	10.6	7.6	—3.0
TOTAL	$85.4	$76.8	—8.6

In the largest of these categories — the Military Establishment — the Senator proposes an overall cut of 5 per cent. He calls for a reduction of 105,000 civilian employees, instead of the 100,000 increase requested by the President. Pointing out that the proposed reduction, representing a saving of $1,260 million in salary and expense costs, comes to less than 10 per cent of the President's request for civilian employment in this Department, he expresses doubt "whether anyone outside the Military Establishment will contend seriously that the armed services are not 10 per cent inefficient in their utilization of manpower."

Included also in the recommended military reductions are $500 million for public works, "largely through elimination of non-essential land acquisition and construction details," and $800 million from other appropriations, principally for "so-called maintenance and operations — the big, broad budgetary umbrella under which all manner of wasteful sin is committed." While disclaiming any desire to slow down or curtail the defense effort, the Senator states that "as a member of the Armed Services Committee, I know that vast additional sums can be saved and the military effort improved by full and sympathetic use of the business procedures established in the Eberstadt amendments to the Unification Act."

In foreign aid, the recommended reductions eliminate expenditures for economic aid abroad and reduce overhead in the military program by $100 million "through increased efficiency." Military aid would not be disturbed otherwise. "Since World War II (the statement says) we have already poured some $40 billion into foreign countries in an effort to prop up their economies and buy their friendship." It is contemplated that "much of the money going to military aid programs will find its way into foreign economies and suffice for paralleling and overlapping economic programs."

Proposed cuts in Veterans Administration outlays come to $200 million. Recalling that this

office "has gone through numerous highly publicized reorganizations," the statement observes that "it is time these reorganizations were paying off in administrative efficiency." Recommended cuts in administrative personnel, exclusive of doctors, nurses, and related employees in the hospital service, total $100 million. In addition, "another $100 million could be saved by eliminating abuse of medical and surgery facilities by those who seek non-service connected hospitalization."

Domestic-civilian programs would be cut $3 billion. There is not space here to list the detailed changes, which affect all the major civilian budget classifications. They include cuts of $400 million in Social Welfare, Health and Security; $300 million in Housing and Community Facilities; $300 million in Education and General Research; $300 million in Agriculture and Agricultural Resources; $700 million in Natural Resources (which includes the federal power program); $300 million in Transportation and Communication (which includes the postal deficit); $400 million in Finance, Commerce and Industry; $100 million in Labor; and $200 million in General Government.

All recommendations are spelled out and the reasons given, as in the case of proposed cuts in the defense and defense-related categories.

Corroborative Evidence

It is not necessary to agree with every recommendation to recognize that here is a painstaking and constructive piece of work. It is fair to say that no member of the Congress is more thoroughly informed in these matters than Senator Byrd.

Whether or not the Byrd program is right in detail, there is a wealth of corroboratory evidence of lavish and wasteful government spending of the taxpayer's money. The testimony of such experienced legislators as Senator George and Senator Douglas has already been cited. In addition, there are the findings of Congressional committees, and of private bodies such as the Committee on Federal Tax Policy, the Council of State Chambers of Commerce, and others.

We referred in these columns a month ago to the reports of the Senate Preparedness subcommittee, headed by Senator Lyndon B. Johnson, scoring the military for "inexcusable waste" and "lack of any real cost consciousness." Since then new testimony before the same subcommittee has brought out charges of the squandering of millions of dollars through confused planning, faulty construction, and shady practices in the North African air base development program.

No doubt many of our readers noted reports in the press within the past month of glaring examples of wasteful military buying dug up by the House Armed Services subcommittee, chairman, Representative F. Edward Hebert. This subcommittee, which has been investigating military buying methods, commenced public hearings on February 16 in its committee room, dubbed a "chamber of horrors" by the chairman for its large exhibit of comparable items bought by the military at widely varying prices.

Defense officials, while admitting that mistakes have been made, claim that charges of waste have been overdrawn. They emphasize steps taken to improve procurement and to tighten up generally. It is apparent, however, that much more needs to be done. Testimony of private concerns doing business with the Government supports, in too many instances, other evidence that defense buying is still way out of line in many directions and must be put on a more efficient basis.

Effects of Conflicting Policies

In fairness to the military, it should be pointed out that procurement officers are handicapped by extraneous pressures resulting from the mixing of military buying with such social and political objectives as relieving unemployment, helping small business, enforcing wage and labor regulations, and the like. Rear Admiral Morton C. Ring, vice chairman of the Munitions Board's office of supply, in testifying before the House Armed Services subcommittee, told how purchasing officers must keep in mind and be guided by "at least fourteen major" policies of the Congress and the Government. This, he declared, makes it "most difficult" for buyers to "get the greatest value at the lowest cost to the taxpayer."

These fourteen "major policies," handed down from the White House, the National Security Council, Congress, the Defense Department, and the Office of Defense Mobilization, were summarized by Scripps-Howard staff writer Jim G. Lucas, reporting the testimony, as follows:

1. Get the most for the Government's money.
2. Not buy in advance of needs.
3. Favor small business.
4. Honor the "buy America" clause in the law governing stockpiling.
5. Favor distressed areas.
6. Maintain economic equity between geographical areas and groups.

7. Favor firms which have received low allotments of controlled materials.

8. Broaden the nation's economic base.

9. Encourage the dispersal of industry.

10. Avoid concentration of economic power.

11. Support the Government's anti-monopoly program.

12. Enforce mandatory anti-discrimination, child labor, fair labor, minimum wage, and compulsory subcontracting laws and regulations.

13. Implement mobilization and planning activities.

14. Award contracts, if deemed necessary, to distressed areas, even though there are no low bidders there. (The purchasing officer must, however, be prepared to justify his decision.)

With this formidable array of requirements, it is small wonder if Number 1 on the list – get the most for the Government's money – gets lost in the shuffle. "If you ask me which one I would follow," Admiral Ring is quoted as having told the subcommittee, "I would say that I would follow the one on which the pressure was the greatest and then duck."

Under a policy directive by Defense Mobilization Chief Charles E. Wilson, handed down last month and included in the above list, armed service purchasing officers are authorized to pay premiums of 10 to 15 per cent in order to channel defense contracts to small business and to areas where unemployment is a critical problem. This directive has aroused a storm of protest in some quarters, particularly Southern textile interests, which feel they will be discriminated against, but has been taken very seriously by officials of the Small Defense Plants Administration, recently designated by Executive Order as spokesman and guardian for small business.

In a speech in Pittsburgh last month, Small Defense Plants Administrator Telford Taylor spoke his mind regarding testimony of a "Munitions Board procurement official" (later identified as Admiral Ring) before a House Armed Services subcommittee. Condemning Admiral Ring's expressed opinion that a procurement man's job is to get the most for the public's money in the quickest time as ignoring "the Government's obligation to counter-balance the disruptive effects which the rearmament program would otherwise have on the national economy," he characterized this attitude as revealing a "failure to recognize the Government's obligation to award small business a greater share of procurement." It reflects, he asserted, an "outdated attitude based on practices of bygone years, when Government procurement had far less effect on the economy."

Two Ways to Cut the Budget

All this goes to sustain the contentions of Senator Byrd and others that there is a great deal of "fat" in the budget which can be cut out if we really make up our minds to it.

There are two ways to go about cutting the budget.

One is for Congress to try to do the cutting itself, hacking away at individual items in the budget. This has been tried before but has not worked very well. The reason is partly because of log-rolling and partly because not even the members of the appropriations committees, to say nothing of Congress at large, can possibly, within the limited time available and without more of a staff of experts, be well enough posted on all the countless detail of government work to stand up against the pressures of Administration officials who come before them armed to the teeth with reasons why appropriations for their particular offices should not be cut.

Another way to cut the budget is embodied in the resolution introduced in the House on the first day of the present session by Representative Frederic R. Coudert, Jr., Republican, of New York, setting a ceiling on expenditures for fiscal 1953, and requesting the President to submit, in addition to the regular budget, an alternative budget holding expenditures within that limit. In this way, the responsibility for making the cuts would fall on the President and on the Bureau of the Budget, which is best equipped with the necessary information to make the selections.

The Coudert resolution, which has been endorsed unanimously by the House Republican Policy Committee, and a concurrent resolution in the Senate by Senator Johnson, Democrat, of California, set the ceiling at the estimated revenues of $71 billion for the year. Subsequently, a resolution, providing simply for holding expenditures within estimated revenues without specifying the amount, and inserting the proviso "except in the event of war hereafter declared by the Congress", was introduced in the Senate jointly by Senators Ecton, Bridges, and Ferguson.

But whatever the method selected to cut the budget, the need for prompt and decisive action is urgent.

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